



California Public Employees' Retirement System
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November 15, 2011

Macias, Gini, & O'Connell, LLP
Certified Public Accountants
3000 S Street, Suite 300
Sacramento, CA 95816

Dear Macias, Gini, & O'Connell, LLP,

We are providing this letter in connection with your audit of the financial statements of the California Public Employees' Retirement System (System) as of June 30, 2011 and for the year then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the statement of fiduciary net assets of the fiduciary funds and the statement of net assets of the proprietary funds and the respective changes in financial position and, where applicable, cash flows thereof in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with U.S. generally accepted accounting principles. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement. An omission or misstatement that is monetarily small in amount could be considered material as a result of qualitative factors.

We confirm, to the best of our knowledge and belief, as of November 15, 2011, the following representations made to you during your audit.

- 1) The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.

- 2) We have made available to you all:
 - a) Financial records and related data.
 - b) Minutes of the meetings of the Board of Administration and committees of the Board of Administration of the System or summaries of actions of recent meetings for which minutes have not yet been prepared.
 - c) Amendments made to the Plan documents, the trust agreements, or insurance contracts (if applicable) during the year, including amendments to comply with applicable laws.
 - d) Actuarial valuation reports and other reports prepared by the CalPERS actuarial personnel for the System and by external actuaries, as appropriate.
 - e) Amendments made to the California Public Retirement Law (PERL), Legislators' Retirement Law, Judges' Retirement Law, and Judges' Retirement Law II during the year, including amendments to comply with applicable laws.
- 3) There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
- 4) There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
- 5) We believe the effects of the uncorrected financial statement misstatements summarized in the attached schedule are immaterial, both individually and in the aggregate, to the financial statements.
- 6) We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
- 7) We have no knowledge of any fraud or suspected fraud affecting the entity, where the fraud, or suspected fraud, could have a material effect on the financial statements and which involves:
 - a) Management,
 - b) Employees who have significant roles in internal control, or
 - c) Others where the fraud could have a material effect on the financial statements.
- 8) We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others, which could have a material effect on the financial statements.
- 9) We have a process to track the status of audit findings and recommendations.
- 10) We have identified to you any previous financial audits, attestation engagements, performance audits, or other studies related to the audit objectives and whether related recommendations have been implemented.
- 11) We have provided our views on reported findings, conclusions, and recommendations, as well as our planned corrective actions, for the report.
- 12) The System has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.
- 13) The following, if any, have been properly recorded or disclosed in the financial statements:

- a) Related party transactions, including revenues, additions/expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
 - b) Guarantees, whether written or oral, under which the System is contingently liable.
 - c) All accounting estimates that could be material to the financial statements, including the key factors and significant assumptions underlying those estimates and measurements. We believe the estimates and measurements are reasonable in the circumstances, consistently applied, and adequately disclosed.
- 14) We are responsible for compliance with the laws, regulations, and provisions of contracts and agreements applicable to us, including tax or debt limits and debt contracts; and we have identified and disclosed to you all laws, regulations and provisions of contracts and agreements that we believe have a direct and material effect on the determination of financial statement amounts, or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
- 15) There are no:
- a) Violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.
 - b) Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with *Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies*.
 - c) Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.
 - d) Material transactions that have not been properly recorded in the accounting records underlying the financial statements.
 - e) Other matters that legal counsel has advised us that must be disclosed.
- 16) The System has satisfactory title to all owned assets, and there are industry standard liens or encumbrances on certain assets that have been pledged as collateral.
- 17) The System has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- 18) We have followed all applicable laws and regulations in adopting, approving, amending and reporting budgets.
- 19) We have apprised you of all communications, whether written or oral, with regulatory agencies concerning the operation of the System, which could have a material effect on the financial statements.
- 20) With respect to the State Peace Officers' and Firefighters Fund, the suspension of contributions by the State of California effective April 2011 for rank and file positions; and effective May 2011 for supervisors, management, and exempt positions, have been properly reported and disclosed in the financial statements.

- 21) The System is qualified under the appropriate section of the Internal Revenue Code and we intend to continue as a qualified System. The System's Board has operated the System in a manner that did not jeopardize this tax status.
- 22) There have been no reviews or inquiries by the IRS or other regulatory agency of the System's activities or filings during the period of audit or through the current date, which could have a material effect on the financial statements.
- 23) We believe that the actuarial assumptions and methods used by the System's pension actuaries and third-party other postemployment benefits (OPEB) actuaries (for the California Employers' Retirement Benefit Trust Fund (CERBTf)) for purposes of financial reporting in accordance with generally accepted accounting principles, including the determination of required contributions and actuarial accrued liabilities for pension benefits and OPEB, are appropriate in the circumstances. We are responsible for the actuarial assumptions and methods used by the System's actuaries for financial reporting and funding purposes and for determining the actuarial accrued liabilities. We have no knowledge or belief that would make such assumptions or methods inappropriate in the circumstances. We did not give any, nor cause any, instructions to be given to the System's or third-party actuaries with respect to values or amounts derived and we are not aware of any matters that have impacted the objectivity of the System's or third-party actuaries.
- 24) We believe that inaccuracies in member data provided by contributing employers do not result in material miscalculations of benefits, actuarially derived amounts or other amounts in the System's financial statements.
- 25) There have been no changes in the methods or significant assumptions used to determine the actuarial accrued liabilities for pension and other postemployment benefits, except as described in Notes 5 and 10 to the financial statements.
- 26) There were no omissions from the participants' demographic data provided to the System's actuaries for the purpose of determining the actuarial accrued liabilities and required contribution rates for the defined benefit pension and other postemployment plans, the Health Care Fund liability for claims incurred but not reported and the Long-term Care Fund liability for future policy benefits and other actuarially determined amounts reflected in the financial statements.
- 27) The System has properly applied the provisions of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans* and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employers*, and actuarial data contained in the financial statements, relating to the CERBTf, was derived in accordance with the parameters of the statement as well as the *CalPERS OPEB Assumption Model*.
- 28) The System has established sufficient internal controls over the CERBTf activities to ensure that trust disbursements are made only for eligible retirees or their beneficiaries as defined by the terms of the respective employers' plans.
- 29) The System has properly applied the provisions of GASB Statement No. 50, *Pension Disclosures – An Amendment of GASB Statements No. 25 and 27*, and actuarial data contained in the financial statements, relating to the defined benefit pension plans, was derived in accordance with the parameters of the statement.

- 30) The potential impact of deferred fiscal year 2008-09 investment losses that will be recognized in the actuarial value of assets in future valuations has been properly disclosed.
- 31) We agree with the work of the actuaries in evaluating the liability for claims incurred but not reported for the Health Care Fund and for future policy benefits for the Long-Term Care Fund. We have adequately considered the qualifications of the actuaries in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give any instructions, nor cause any instructions to be given, to the actuaries with respect to the values or amounts derived in an attempt to bias their work, and we are not aware of any matters that have affected the independence or objectivity of the actuaries. We believe that there will not be material changes to the June 30, 2011 draft actuarial valuation report dated October 18, 2011, compared to the final approved actuarial valuation report for the Long-Term Care Fund.
- 32) We agree with the work of the specialists in evaluating the appraised value of real estate investments held by the System and have adequately considered the qualifications of the specialists in determining amounts and disclosures used in the financial statements and underlying accounting records. We did not give any instructions, nor cause any instructions to be given, to the specialists with respect to values or amounts derived in an attempt to bias their work, and we are not aware of any matters that have affected the independence or objectivity of the specialists.
- 33) All real estate investment appraisals completed in fiscal year 2011 have been reconciled with and agreed to the real estate funds' or advisors' June 30, 2011 financial statements. Management recognizes there are a certain immaterial assets which cannot be reconciled due to reporting limitations in partner supplied financial statements.
- 34) Real estate asset transfers are properly recorded in the financial statements and the beginning real estate fair value reported by the new partners have been reviewed and approved by appropriate CalPERS investment personnel.
- 35) Deposits and investment securities are properly classified as to risk in accordance with the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3*.
- 36) We believe that the System's investments considered to be highly sensitive to interest rate changes, as described in paragraph 16 of GASB Statement No. 40 are adequately disclosed in footnote 4 to the financial statements.
- 37) The fair value of investments in unitized portfolios are properly allocated and reported in the respective fund financial statements at June 30, 2011.
- 38) The System believes that it has properly identified all derivative instruments and the fair values of all derivatives have been determined based on prevailing market prices or by using financial models that we believe are the most appropriate models for valuing such instruments and that incorporate market data and other assumptions that we have determined to be reasonable and appropriate.
- 39) Derivative instruments are properly classified and disclosed in accordance with the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for*

Derivative Instruments. In addition, none of the derivatives held by the System met the definition of hedging transactions under GASB Statement No. 53.

- 40) We believe that the System's derivative instruments considered to be highly sensitive to interest rate changes, as described in paragraph 76 (b) of GASB Statement No. 53 are adequately disclosed in footnote 4 to the financial statements.
- 41) The methods and significant assumptions used to estimate fair values of financial instruments, including non-readily marketable securities are proper based on the provision of Governmental Accounting Standards Board Statement No. 25, and are summarized as follows:
 - a) The measurement methods, including the related assumptions, used in determining fair value were appropriate and were consistently applied.
 - b) The fair values of investments are generally based on published market prices and quotations from major investment firms.
 - c) International investments are based on quoted exchange rates.
 - d) Short-term investments are reported at cost or amortized cost, which approximates fair value.
 - e) Real estate investment fair values are determined by management based on net asset values provided by general partners as reflected in the related partnerships' June 30, 2011 financial statements and recent estimates provided by the System's contract real estate advisors or independent appraisers.
 - f) Alternative investment fair values are determined by management, based on net asset values provided by general partners and investment advisors, as reflected in the related partnerships' June 30, 2011 financial statements or the most recent financial information adjusted for cash flow activities through June 30, 2011.
 - i) Inflation Linked Asset Class investment fair values are determined as follows:
 - ii) Inflation linked bonds, commodities, and foreign currency investments are based on published market prices and quotations from major investments firms.
 - iii) Forestland and infrastructure investments are determined by management based on net asset values provided by general partners as reflected in the related partnerships' June 30, 2011 financial statements.
- 42) We are in agreement with the methods and approach used by investment advisors and appraisers in determining the fair values of real estate investments, alternative investments, and other investments where no readily ascertainable market value exists.
- 43) The System has properly recorded and disclosed securities lending transactions as follows:
 - a) Securities lending collateral which represents reinvested cash collateral is properly recorded at fair value. The fair value of securities lending collateral is based on published market prices and quotations from major investments firms. For money market securities, fair value is based on the amortized cost which approximates fair value.

- b) The related security lending income, expenses, and realized and unrealized gains and losses are properly recorded in the financial statements.
 - c) The System does not invest in a cash collateral pool, as such has properly disclosed reinvested cash collateral in accordance with the requirements of GASBS No. 40.
 - d) Investments in the unitized portfolios may be lent as part of the securities lending program. The Public Employees Retirement Fund bears the risk of loss in the re-invested collateral.
 - e) The allocation of certain securities lending income to the unitized portfolio pool owners in fiscal year ending 2011 was approved and properly recorded.
- 44) Investments, loans, or leases that are in default or that are considered to be uncollectible have been properly recorded and disclosed in the financial statements.
- 45) There are no material violations of finance related legal and contractual provisions with respect to real estate related debt or other contractual obligations, and all unfunded commitments have been properly disclosed in Note 6 to the financial statements.
- 46) Transactions and activities with off-balance sheet risk have been properly disclosed in the financial statements.
- 47) There are no significant losses or loss contingencies associated with the credit enhancement program.
- 48) Provision has been made for losses to be sustained in the fulfillment of, or from inability to fulfill, any commitments to purchase or sell securities under forward placement, financial futures contracts, and standby commitments.
- 49) With respect to the System's investment holdings:
- a) There have been no material declines in fair values subsequent to the balance sheet date and through the date of this letter which would require disclosure in the financial statements.
 - b) All investment holdings are considered to be marketable and the System has sufficient liquidity to pay obligations as they become due.
 - c) In August 2011, Standard & Poor's lowered its long-term credit rating from AAA to AA+ on debt of the U.S. government, U.S government- sponsored enterprises, and public debt issues that have credit enhancement guarantees by U.S. government sponsored enterprises. These credit downgrades did not have a material impact on CalPERS investments or financial statements.
 - d) Exposure to hedge funds has been properly disclosed.
 - e) Arrangements with financial institutions involving repurchase, reverse repurchase, or securities lending agreements, compensating balances, or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements, have been properly recorded or disclosed in the financial statements.
- 50) Receivables recorded in the financial statements represent valid claims or other charges arising on or before the date of the statement of net assets available for benefits and have been appropriately reduced to their estimated net realizable value.

- 51) The System is responsible for determining and maintaining the adequacy of the allowance for doubtful notes, loans, and accounts receivable, as well as estimates used to determine such amounts. The System believes the allowances adequately reflect currently estimated bad debts in the account balances.
- 52) Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated.
- 53) The System has properly applied the provisions of GASBS No. 51, Accounting and Financial Reporting for Intangible Assets and has elected to retroactively capitalize the expenses incurred for the Pension System Resumption Project.
- 54) Contributions for the deferred Compensation Program (IRC 457), SPC (Supplemental Contributions Program) and State Peace Officers' and Firefighters' Defined Contribution Plan (SPOFF) funds are properly classified and recorded.
- 55) We believe that contributions were made in accordance with applicable plan provisions or State statute. However, the actuarial valuation report as of June 30, 2010 for the Judges Retirement Fund (JRF) indicated that the JRF will not be able to pay the accumulated benefits due in 2012 without the State General Fund Augmentation.
- 56) We believe, based on the advice of legal counsel, that the State of California is legally obligated to provide contributions sufficient to pay benefits of the Judges' Retirement Fund when the benefits are due.
- 57) Federal government reimbursements under the Early Retiree Reinsurance Program (ERRP) are properly recorded in the Health Care Fund and the Contingency Reserve Agency Fund. The System has complied with ERRP program requirements, and pass-through resources reported in the Contingency Reserve Agency Fund have been properly disbursed to health carriers as appropriate.
- 58) We believe that the allocation of administrative expenses to the funds administered by the System is based on a fair and reasonable methodology and the assumptions used were the most appropriate in the circumstances.
- 59) The System has refrained from reporting encumbrances as administrative expenses in the financial statements until such time that the related liability has been incurred.
- 60) Administrative expenses recorded in the Deferred Compensation Program (IRC 457), SPC (Supplemental Contributions Program) and State Peace Officers' and
- 61) Administrative expenses recorded in the Deferred Compensation Program (IRC 457), SPC (Supplemental Contributions Program) and State Peace Officers' and Firefighters' Defined Contribution Plan (SPOFF) funds are proper and based on actual expenses incurred.
- 62) We believe that the System is properly classified as a component unit of the State of California for financial reporting purposes in accordance with Government Accounting Standards Board (GASB) Statement No. 14.
- 63) We have presented the required supplemental information (RSI) prescribed by GASB No. 25, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosures for Defined Contributions Plans*, and GASB No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans* as prescribed by the GASB.

- 64) Management's discussion and analysis (MD&A) is based on facts, decisions, or conditions currently known to management and does not contain forecasts or other prospective information.
- 65) The financial statements properly classify all funds and activities, and we have determined the Replacement Benefit Fund is properly classified as an agency fund.
- 66) We believe that the statement of changes in assets and liabilities for the Contingency Reserve Fund – Agency activity are accurate and fairly presented.
- 67) The Old Age & Survivor's Insurance (OASI) Revolving Fund is properly classified and activities in the OASI fund are properly included in the Public Employees Retirement Fund.

No events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

DAVE G. CORNEJO, Acting Chief Division
Fiscal Services Division

RUSSELL G. FONG
Acting Chief Financial Officer

ANNE STAUSBOLL
Chief Executive Officer

Attachment

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS
JUNE 30, 2011

| Fund Name | Account Description | Increase / (Decrease) | | | Additions / Revenues | Deductions / Expenses |
|------------------|---|------------------------------|--------------------|-------------------|---------------------------------|----------------------------------|
| | | Assets | Liabilities | Net Assets | | |
| PERF | Equity Securities - Domestic | 516,000,017 | | | | |
| | Equity Securities - International | 470,200,000 | | | | |
| | Alternative Investments | (986,200,017) | | | | |
| | To reclassify fair value of publically traded domestic and international equity securities which are being reported as alternative investments as of June 30, 2011. | | | | | |